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UNCLAS SECTION 01 OF 03 ABUJA 001353

SIPDIS

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DEPARTMENT FOR AF/W (SILSKI) AND AF/EPS (POTASH)
DEPARTMENT PASS TO USTR (AGAMA)
PASS TO EX-IM (THOMAS MATTHIAS AND CHERYL MORIARTY)
DEPT OF ENERGY FOR CAROLYN GAY
DEPT OF TREASURY FOR DPETERS

E.O. 12598: N/A
TAGS: EFIN ECON PGOV NI
SUBJECT: NIGERIA: CURRENT DEBT PROFILE AND FUTURE DEBT PLANS

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¶1. Summary. On June 11, Econ and EXIM bank officers met with Nigeria's Debt Management Office (DMO). The Government of Nigeria's (GON) external debt as of March 2007 stood at $3.287 billion, of which 87% was held by multilateral institutions. Domestic debt totaled 1.87 trillion naira ($14.7 billion). In 2003 after 18 years the GON began re-issuing bonds to restructure short term debt, develop capital markets and handle contractor and pension arrears. After a lull of eight years, they hope to re-introduce government guarantees soon. After undergoing a more rigorous selection process banks can bid electronically. DMO is in the process of developing a similar system for the secondary markets. New borrowings are expected to be executed mainly for state governments and infrastructure projects, but DMO wants to be careful that massive spending does not have an adverse impact on the economy. The DMO expects the GON to amend the DMO Act, especially on concessional lending, which has been a bone of contention. The IMF's Policy Support Instrument (PSI) is set to expire in October 2007, but DMO expects the GON to maintain the same discipline on borrowing and on concesssional lending. End Summary.

¶2. On June 11, Econ officers along with the United States Export Import Bank's (U.S. Ex-Im) Thomas Matthias, Credit Officer, and Cheryl Moriarty, Financial Economist, met with Dr. Mahmoud Magaji, Director, Recording and Settlement, Mr. Yakubu Aliyu, Director, Portfolio Management, and Dr. D. Mahmoud, Assistant Director/Special Assistant to the Director General all of the Debt Management Office (DMO) to discuss Nigeria's current debt profile, debt policy, and future plans of the DMO, as part of ExIm's credit risk analysis of the Nigerian market.
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DMO PRIMER

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¶3. The DMO was set up in October of 2000 and formally established by an act in June 2003 to manage Nigeria's official external and internal debt. At its inception DMO had a mandate to make Nigeria's debt sustainable by 2006. That mandate included transforming Nigeria's debt profile into one that focused borrowing on supporting growth and development. The DMO was heavily involved in the negotiations that resolved the London and Paris Club debts. The external debt situation was now sustainable and the current debts had the concessional component required by the IMF's PSI, according to DMO officials. A new policy framework on government borrowing

was being drafted, and there were plans to reduce domestic debt.
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External Debt Profile

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¶4. Nigeria's external debt at the end of March 2007 was $3.287 billion, according to the DMO. Multilateral debts account for 86.87% of the external debt broken down as follows:

-- $1.619 billion - International Development Association (IDA);
-- $479 million - International Bank for Reconstruction (IBRD) and Development;
-- $386 million - African Development Bank (ADB);
-- $347 million - Non-Paris Club bilateral debt;
-- $199.9 million - African Development Fund (ADF;
-- $129 million - European Development Fund (EUF)
-- $84 million - Non-Paris Club commercial debt;
-- $40 million - International Fund for Agricultural development;
-- $2 million - European Investment Bank (EUB)

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Domestic Debt Profile

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¶5. Total domestic debt at the end of March 2007 was 1.87 trillion naira ($14.7 billion). Most of the domestic debt is held by banks, while other holders of the debt include insurance companies, pension funds, and discount houses. The debt comprises:

-- 754 billion naira ($5.9 billion), representing 40.4 percent of domestic debt in Federal Government of Nigeria Bonds;
-- 698 billion naira ($5.4 billion, representing 37.4 percent of domestic debt in Treasury Bills; and
-- 413 billion naira ($3.25 billion), representing 22.16 percent of domestic debt in- Treasury Bonds;
-- 720 million naira ($5.67 million), representing 0.04 percent of domestic debt in Development Stocks.

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Bond Market

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¶6. The GON began restructuring its domestic debt in 2004 by replacing the 91-day treasury bills with longer duration bonds ranging from 3 to 7 years. In 2003, after an eighteen-year gap, the GON re-entered the bond markets with the objectives of financing budget deficits, restructuring short-term to long-term debt, developing the capital markets, settling contractor and pension arrears and being more active with treasury bills and Federal Mortgage Bank of Nigeria bonds. Also, after eight years, the GON was designing a program for government guarantees to be in place by July/August 2007.
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Recent Activity

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¶7. DMO issued special bonds for pensioners (July 2007 of 75 billion naira ($590.5 million) with a coupon rate of 12.5%) and Local Contractors (September 2006 of 87.7 billion naira ($690.5 million) with a coupon rate of 13.5% and on December 2006 of 4.1 billion naira ($32.3 million) with a coupon rate of 13.5%). As of March 2007 four bond issuances have occurred:

-- January 2007 - 40 billion naira ($314.9 million) with a maturity of three years (2010)
-- Feb 2007 - 35 billion naira ($275.6 million) with maturity of five years (2012)
-- March 2007- 35 billion naira ($275.6 million) with a maturity of seven years (2014)

¶8. The DMO instituted an auction system where issues are pre-announced and banks can electronically bid. Competition has increased for the products and transaction costs are coming down. The debt market is made up of 20 institutions comprised of 15 banks

and five discount houses. This system is doing very well based on a rigorous selection process that screens institutions, according to the DMO. Each entity's capital base, experience in the securities market and ability to compete in the secondary markets are examined, and put into a quantitative point structure for final selection. A secondary over-the-counter market in bonds is presently constrained by technical glitches, one of which is the Central Bank of Nigeria's (CBN) inability to allow multiple trades. To address this, DMO is putting in place another electronic trading platform and has hired consultants to evaluate at least two options from Bloomberg and Reuters.

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New borrowings

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¶9. All requests are made through the DMO with public sector financing initiated from the Ministry of Finance. New borrowings would be primarily for state governments and infrastructure. GON officials plan to issue the bonds and on-lend the funds to the state governments, but the framework is yet to be concluded. Recent infrastructure legislation has been passed which provides for a commission to be established that will facilitate the DMO. So far, based on the president's pronouncements the power and rail sectors are priority sectors that will receive infrastructure financing. The DMO reported that it wanted to be careful that massive spending does not have an adverse macroeconomic effect on the economy.

¶10. There are also plans to amend the DMO Act to strengthen its control functions and guidelines for concessional lending that would include constraints, rates and tenure of terms. Concessionality has been an area of contention in its interpretation. The DMO staff indicated that there are many definitions (i.e. OECD) and none that is universally recognized in the world. They are looking for relaxed conditions for qualifying infrastructure based on the type of investments and DMO is in the process of preparing a paper to present to the IMF. They recognize the positive impact the PSI has had on debt reduction, but the PSI will expire in October and there are no plans for an extension. The DMO expects the federal and state governments to maintain discipline in borrowing and concessional lending requirements.

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Comment

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¶11. DMO was created to put the GON on a solid debt management regime. The transformation of Nigeria's debt situation is one of the clear accomplishments of the previous administration. The reinstitution of government guarantees could present some pitfalls. Strong discipline and political will be needed to ensure they are only given for financially viable projects with sound management that have clear development objectives or infrastructure needs. The recently passed Fiscal Responsibility Bill (FRB) does not require the same level of transparency and accountability of state and local governments, who receive approximately 50% of all revenues, as it does for the federal government. A high level of transparency and accountability should be demanded from state and local governments that seek such federal guarantees.

CAMPBELL